



DEPARTMENT OF
FINANCE

ARNOLD SCHWARZENEGGER, GOVERNOR

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December 26, 2007

Mr. Michael C. Genest, Director
Department of Finance
State Capitol, Room 1145
Sacramento, CA 95814

Dear Mr. Genest:

Final Report: Department of Finance—Risk and Control Assessment

Enclosed is the final Risk and Control Assessment of the Department of Finance (Finance). The Office of State Audits and Evaluations (OSAE) performed this review to help Finance meet the requirements of the Financial Integrity and State Manager's Accountability Act of 1983, Government Code Section 13400, et. Seq. (FISMA).

The findings in our report are intended to assist Finance management in focusing attention on areas of risk, strengthening internal control, and improving operations. Finance agreed with our findings and its response and corrective action plan is incorporated into this report.

FISMA requires you to submit copies of this report to the State Legislature, the State Auditor, the Governor, the Director of the Department of Finance (Director), and the State Library. Since this report is internal to the Department of Finance, please provide the Director's copy directly to OSAE. FISMA also requires you to provide an updated corrective action plan every six months until all corrections are completed. Mail the Director's copy and your corrective action plans to:

Department of Finance
Office of State Audits and Evaluations
300 Capitol Mall, Suite 801
Sacramento, CA 95814

OSAE appreciates the assistance and cooperation of Finance staff and management during the evaluation. If you have any questions regarding this report, please contact Kim Tarvin, Manager, or John Rogers, Supervisor, at (916) 322-2985.

Sincerely,

Original signed by Richard Sierra for:

Janet I. Rosman, Assistant Chief
Office of State Audits and Evaluations

Enclosure

cc: Ms. Debbie Chambliss, Chief of Administration, Department of Finance

RISK AND CONTROL ASSESSMENT

Department of Finance

Prepared By:
Office of State Audits and Evaluations
Department of Finance

EXECUTIVE SUMMARY

This Risk and Control Assessment of the Department of Finance (Finance) was performed by the Office of State Audits and Evaluations (OSAE) to comply with the reporting provisions of the Financial Integrity and State Manager's Accountability Act of 1983, Government Code Section 13400, et. seq. The Risk and Control Assessment focused on determining whether internal accounting and administrative program controls are functioning as intended to mitigate risks to the department that could hinder the achievement of Finance's mission.

As of August 2, 2007, many accounting and administrative controls were functioning as intended to mitigate risks. Correcting the issues noted below and resolving prior findings will assist Finance in enhancing its internal control, focusing attention on areas of risk, and improving operations. OSAE staff met with Finance management on November 1, 2007, to discuss the following observations.

Human Resources

- Inaccurate data in the State Controller's Office's (SCO) California Leave Accounting System (CLAS) could cause the state to incur excess costs. For the period from January 2006 through February 2007, 253 instances were identified where Finance's records did not agree with the data in the CLAS Leave Benefit History Summary Inquiry Report. Finance should develop an action plan and timeline to correct the discrepancies and implement procedures to verify the accuracy of data entered into CLAS.
- Finance may unknowingly fill an abolished position or lose an established position because the status of open or abolished positions cannot be accurately determined. To correct this weakness, Finance should timely provide the Change in Established Positions forms to the SCO, follow up on the SCO Uniform State Payroll System exceptions reports, and reconcile the Finance Administration System (FAS) to the SCO's personnel system.
- Employees could be hired in positions for which they do not meet the requirements because the Request for Personnel Action form is not always approved by the Human Resources Office prior to the effective hire date of the employee. Training should be provided to the individuals that have the authority to make hiring decisions and the Unit Coordinators responsible for submitting personnel documents.

Information Technology

- Application modification testing for the FAS was inadequate following an upgrade in April 2007 to ensure that the system changes functioned as intended. For future application modifications, Finance should implement procedures to ensure that adequate application modification testing is performed.

Prior Findings

The 2005 Internal Control Review indicated that controls could be improved in the areas of property, information technology, and contracts. The findings and current status are reported below:

Finding	Status
Property not tagged and recorded.	Unresolved—Inventory software system was purchased and installed. However, only minimal property has been recorded in the new system and some property still needs to be tagged.
Public, confidential, and sensitive data not defined in a written policy.	Partially Resolved—A data classification document was developed. However, the document still requires approval and distribution to staff.
Information Security Officer duties not clearly defined in a written document.	Resolved.
Contractor evaluations not completed.	Resolved.

STAFF:

Kim Tarvin, CPA
Manager

John Rogers, CPA
Supervisor

Alex Balandra
Dennis Solheim

BACKGROUND, OBJECTIVES, SCOPE, AND METHODOLOGY

Background

The Department of Finance (Finance) serves as the Governor's chief policy advisor, promotes responsible resource allocation through the state's annual financial plan, and ensures the financial integrity of the state. Finance achieves these objectives through the following activities:

- Preparing, enacting, and administering the California Budget.
- Providing the budgeting and control of state information technology expenditures.
- Analyzing and proposing legislation.
- Developing, maintaining, and supporting the California State Accounting and Reporting System (CALSTARS) operations.
- Performing audits and reviews.
- Coordinating the Financial Information System for California project (FI\$CAL).
- Conducting demographic, economic, and financial research.
- Providing fiscal consulting and systems services to other departments.
- Developing policies for the use of data processing resources to support state programs.

The Legislature enacted the Financial Integrity and State Manager's Accountability Act of 1983, Government Code Section 13400, et. seq. which charged each state agency with the responsibility of maintaining effective systems of internal accounting and administrative program control as an integral part of its management practices. The Legislature also mandated that the systems of internal accounting and administrative program control be evaluated on an ongoing basis. The Office of State Audits and Evaluations (OSAE) performed this Risk and Control Assessment to comply with the reporting provisions of the Financial Integrity and State Manager's Accountability Act of 1983, Government Code Section 13400, et. seq.

Objectives and Scope

The objective of the Risk and Control Assessment was to determine whether internal accounting and administrative program controls are functioning as intended to mitigate risks to the department that could hinder the achievement of Finance's mission. To achieve this objective, the assessment focused on the administrative and accounting controls related to Human Resources, Business Services, and Information Services. The assessment did not include accounting functions performed by the Department of General Services, Budget operations, CALSTARS support functions, or FI\$CAL.

Methodology

Interviews with Finance's management staff were held to identify the most significant concerns and mitigating accounting and administrative program controls that impact the operations of Finance. Based on these interviews, previous internal control findings, and auditor judgment, the following areas were identified for review:

- Purchasing
- Contracting
- Leave balance accounting
- Personnel position tracking practices
- Information systems maintenance
- Fixed asset tagging and recording
- Confidential and sensitive data procedures
- Information Security Officer duties

For each of these areas, an understanding of the procedures was obtained, the accounting and program controls were identified, and information and documentation provided was reviewed to determine whether the accounting and program controls were adequate. Based on this analysis, recommendations were developed to enhance Finance's internal control, mitigate risks, and improve operations. The observations and recommendations in this report are based on fieldwork performed between May 9 and August 2, 2007.

OBSERVATIONS AND RECOMMENDATIONS

The Risk and Control Assessment of the Department of Finance's (Finance) accounting and administrative controls in effect as of August 2, 2007, indicates that many controls were functioning as intended to mitigate risks to Finance. However, implementation of the following observations and recommendations would enhance Finance's accounting and administrative controls, mitigate risks, and improve operations.

HUMAN RESOURCES OFFICE

Observation 1 Leave Accounting Errors May Result in Loss of State Resources

Inaccurate data entered into the State Controller's Office's (SCO) California Leave Accounting System (CLAS) could cause the State to incur excess costs. Specifically, 253 instances were identified between January 2006 and February 2007 where the data recorded in Finance's records did not agree with the CLAS Leave Benefit History Summary Inquiry Report. State Administrative Manual (SAM) Section 8539 states that agencies will maintain complete records of attendance and absences for each employee during each pay period. SAM Section 4841 requires each agency to provide for the integrity of automated information produced or used in the course of agency operations.

Recommendation: Develop an action plan and timeline to correct the discrepancies identified, and implement procedures to verify the accuracy of data entered into CLAS.

Observation 2 Open and Abolished Positions Cannot Be Accurately Identified

Finance may unknowingly fill an abolished position or lose an established position because the status of open or abolished positions cannot be accurately determined. The information in the SCO Uniform State Payroll System (USPS) is inaccurate because the Change in Established Position forms have not been submitted to the SCO for the past year, and the discrepancies listed on the USPS exceptions reports are not reviewed and corrected. As a result, the SCO Periodic Position Control Report dated June 1, 2007 indicated that 68 payroll warrants were issued for invalid positions. Furthermore, the established and abolished positions recorded in the Finance Administration System (FAS) are not tracked, monitored, or reconciled to the USPS. Generally accepted internal control procedures require that accurate information be maintained and that reconciliations be completed to ensure that data required for effective and efficient operations is reliable.

Recommendation: Accurately maintain the status of open and abolished positions, timely provide the Change in Established Positions forms to the SCO, follow up on the USPS exceptions reports, and reconcile the FAS to the USPS.

Observation 3 Personnel Action Requests Not Approved Prior to Effective Hire Date

Employees could be hired without meeting the position requirements when the Request for Personnel Action form is not approved by the Human Resources Office prior to the effective hire date of the employee. Of 36 Request for Personnel Action documents reviewed that were prepared for new hires, 6 were submitted to the Human Resources Office after the employee's effective hire date. Finance's Administrative Policy Manual, Section 201.00, states that no final commitments on personnel actions should be made until all required approvals have been obtained and the Human Resources Office has so informed the originating unit.

Recommendation: To ensure that Requests for Personnel Action forms are submitted to the Human Resources Office and approved before final hiring commitments are made, provide training to the individuals with authority to make hiring decisions and the Unit Coordinators responsible for submitting personnel documents.

INFORMATION SERVICES

Observation 4 Application Modification Testing Was Inadequate

Application modification testing for the FAS was inadequate to ensure that the system functioned as intended after changes were implemented. In April 2007, the FAS users experienced reporting problems following an upgrade. Specifically, some of the reports that were accurate prior to the upgrade contained erroneous data after the upgrade. Several meetings with system users were required to identify the problems and several months elapsed before the problems could be corrected. As a result, the FAS application could not be relied upon until the problems were corrected.

Finance maintains 23 information systems on a variety of platforms. These systems are used by various units of Finance. When new systems are implemented, or systems are changed, adequate application modification testing is required to assure that these systems continue to accurately and efficiently function. If a weakness occurred on a critical Finance application during a critical time period, it could have significantly impeded Finance's ability to efficiently meet its responsibilities.

SAM Section 4841 requires each agency to provide for the integrity and security of automated information produced or used in the course of agency operations. SAM Section 4840.4 further defines information integrity as the condition in which information or programs are preserved for their intended purpose, including the accuracy and completeness of information systems and the data maintained within those systems.

Recommendation: Implement procedures to ensure that the required application modification testing steps are performed prior to implementation.

STATUS OF PRIOR FINDINGS

Finance's Internal Control Review, performed in 2005, identified several areas where controls were in place and working as intended. Additionally, the report indicated that controls could be improved in the areas of property, information technology, and contracts. The findings and current status are reported below.

Property

Prior Finding: Finance does not maintain adequate non-information technology property accounting records nor is equipment properly tagged.

Status: Unresolved.

Finance purchased and installed an inventory software system in August 2006. However, as of May 2007, only a minimal amount of property was recorded in the new system and some property still needed to be tagged. To resolve this finding, Finance must tag and record all capitalized and non-capitalized equipment.

Information Security

Prior Finding: Finance's Administrative Policy Manual or other official guidelines do not state when and what data is public, confidential, or sensitive.

Status: Partially Resolved.

Finance drafted a data classification document which is currently in the approval process. To fully resolve this finding, Finance must distribute the data classification document to staff to ensure that all confidential and sensitive data is properly safeguarded.

Prior Finding: Finance does not have a specific charter or job duties for the functions and duties of the Finance Information Security Officer (ISO). Therefore, the job expectations, authority, and duties are not clearly defined in writing.

Status: Resolved.

An Information Security Officer Duty Statement was developed and approved by Finance's executive management and signed by the ISO.

Contracts

Prior Finding: The three completed consultant contracts reviewed did not include the required consultant evaluation.

Status: Resolved.

Consultant evaluations are now completed within 60 days of the contract completion.

RESPONSE



DEPARTMENT OF
FINANCE
OFFICE OF THE DIRECTOR

ARNOLD SCHWARZENEGGER, GOVERNOR

STATE CAPITOL ■ ROOM 1145 ■ SACRAMENTO CA ■ 95814-4998 ■ WWW.DOF.CA.GOV

December 17, 2007

Ms. Janet I. Rosman, Assistant Chief
Office of State Audits and Evaluations
Department of Finance
300 Capitol Mall, Suite 801
Sacramento, CA 95814

Dear Ms. Rosman:

Thank you for the opportunity to respond to the Draft Audit Report on the Department of Finance's Internal Control Review.

We appreciate the efforts of your audit team to assist us in improving our internal controls and processes. Enclosed are the responses to the specific findings. As indicated in these comments, we feel that the recommendations incorporated in the report will assist us in improving our administrative activities.

If you have any questions, please contact Debbie Chambliss, Chief of Administrative Services at (916) 445-3274.

Sincerely,

Original signed by:
MICHAEL C. GENEST
Director

Enclosure

cc: Mr. Fred Klass, Chief Operating Officer, Department of Finance
Ms. Diana Ducay, Program Budget Manager, Department of Finance
Ms. Debbie Chambliss, Staff Services Manager III, Department of Finance

DEPARTMENT OF FINANCE
Response/Corrective Action Plan to Draft Audit Report – Internal Control Review
 December 14, 2007

Prior Finding	Condition	Criteria	Recommendation	Finance Response
1	Inventory is not being recorded and equipment is not properly tagged.	SAM 8650	Implement a property accounting system to record required information on both capitalized and non-capitalized equipment, and properly tag all equipment after acquisition.	We have purchased and installed an Asset Management software package to assist in tracking both capitalized and non-capitalized inventory. A complete physical inventory and equipment tagging has been completed for all property. The recording of all property in the new system will be completed by December 31, 2007. Staff have received training/instruction on the SAM guidelines for future acquisitions.
2	Data has not been formally classified in writing.	SAM 4841.2	Classify Finance's data to protect against unauthorized access and disclosure.	The data classification policy has been developed and is currently under the first level review. The final draft will be submitted to executive management for review and approval by January 15, 2008. Once approved, the policy will be added to the departmental Administrative Policy Manual and disseminated to all staff. Anticipated completion date is February 15, 2008.

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Observation	Current Condition	Corrective Actions Taken	Corrective Actions to be Taken	Date of Action/Planned Action
1	Leave accounting errors may result in loss of state resources.	Human Resources staff have begun the process of researching and resolving the attendance discrepancies reported. In addition, the monthly attendance process has been revamped to improve the reporting of monthly attendance information and help staff verify the accuracy of data entered into CLAS.	Human Resources staff will work to resolve the identified attendance discrepancies.	It is anticipated that this project will be completed by February 29, 2008.
2	Open and abolished positions cannot be accurately identified.	Programming issues related to the Finance Administrative System have been resolved and Human Resources staff have begun the process of researching and reconciling positions to FAS.	Human Resources staff will work to reconcile positions at regularly established intervals.	While routine position reconciliation will remain ongoing, it is anticipated the initial process will be completed by January 31, 2008.
3	Personnel action requests not approved prior to effective hire date.	Human Resources staff provided training to departmental unit coordinators. This training covered the timely completion and submission of requests for personnel action (RPA) forms.	This observation has been completed. RPA processing has been added to the annual training refresher for unit coordinators. All departmental managers/supervisors have been reminded via e-mail of the importance of submitting RPAs timely.	Initial training provided on August 27-28, 2007, and annually thereafter. Reminder notice distributed to all managers/supervisors on December 13, 2007.
4	Application modification testing was inadequate.	System Development Life Cycle protocols (including testing and several checkpoints) were in place. Project staff failed to follow those procedures and has been counseled accordingly. In addition, all staff have been reminded to adhere to the established protocols for application development and implementation.	This observation has been completed.	Project staff counseled on July 9, 2007. All staff reminded to follow established protocols on July 11, 2007. No further action necessary.